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SUBJECT: STOCK EXCHANGE CHIEF EAGER TO MAKE ISTANBUL AN  
INTERNATIONAL FINANCIAL CAPITAL

¶1. (U) Summary. During a January 27 meeting with Ambassador Jeffrey, Istanbul Stock Exchange (ISE) Chief Huseyin Erkan offered his views on how Istanbul can become a major financial center for Turkey and the region. Erkan emphasized that commercial banking alone, even with an offshore component, is not sufficient; in order to build a true financial center Istanbul needs to enhance its capital markets infrastructure. Erkan ultimately sees Istanbul both as the center of a country-wide financial "regime" in Turkey and as a major international center in its own right. Crucial to this new regime would be a fully developed commodities futures market which would serve to securitize key Turkish commodities like hazelnuts, gold and fuel and thus give Turkish producers a more rational price than that given by the state agency and foreign markets. The Ambassador and Erkan also exchanged views on the U.S.-Turkish bilateral commercial relationship, and discussed the potential for partnership in the capital markets sector. End summary.

WERE YOU LONG TURKISH STOCKS IN 2009?

¶2. (SBU) Commenting on the ISE-100's more than 100 percent appreciation in 2009, Erkan observed that the index is heavily weighted in the financial sector (52 percent), and that early in 2009 the market began to discount the strength and profitability of Turkish banking, and also the likelihood that an economic recovery in Turkey would begin later in 2009 and continue into 2010. Also contributing to last year's stock surge were the global wave of financial liquidity and the fact that Turkish stocks had been hammered mercilessly in 2008, leaving them at a low base. The ISE head was still optimistic about stocks in 2010, noting that the ISE's price-to-earnings (P/E) ratio is about 16, well below that of many other emerging markets. Tempering this optimism somewhat was Erkan's view that unemployment in Turkey will remain high this year, thus threatening the sustainability of both the economic recovery and the bull market in stocks. FINANCIAL PARTNERSHIP

¶3. (SBU) Regarding potential coordination and partnership between American and Turkish financial markets, Erkan reported that he communicates regularly with the New York Stock Exchange and the Chicago Board Options Exchange. The ISE, he added, needs international partnerships to introduce new technology for trading and clearing transactions, and to expand its financial product menu. It would welcome closer cooperation with U.S. exchanges in this regard.

THE ISTANBUL STOCK EXCHANGE

¶4. (U) Chairman Erkan also noted that the ISE needs a

greater number of listed companies (Note: Only 120 of Turkey's largest 1000 companies are listed with the ISE, with banks heavily represented in the mix. Also, the free float of these companies is very small -- only a few have made more than 50 percent of their shares available to the public. Of the remaining 880 companies, many are family owned or represent cooperatives, such as the sugar beet industry. End note).

#### ISTANBUL: INTERNATIONAL FINANCIAL HUB?

15. (SBU) Chairman Erkan stressed that banking alone will not make Istanbul a true financial center. He envisions Turkey in the future as a country-wide financial regime, with other cities like Izmir and Adana as key districts and Istanbul as the epicenter (think New York vis-Q-vis Chicago, Houston, etc.). Presently missing from the financial mix, the bourse chief noted, are commodities, which need to be "securitized."

For example, Turkey is the world's leading producer of hazelnuts, but the price of hazelnuts is set in Hamburg, and this puts local producers at a disadvantage. He emphasized that a modern, electronically connected spot and futures derivatives market with standardized contracts would lever the financial system and release economic potential. Erkan postulated a financial leverage ratio of 10-to-1, which would create a large pool of liquidity and foreign exchange that industrialists could use to expand their businesses. He noted that gas, oil and electricity all have potential as traded commodities in Turkey.

#### NEEDED: TAX INCENTIVES AND LICENSED STORAGE FACILITIES

16. (SBU) To stimulate activity in Turkey's numerous --

roughly 100 - but largely inactive commodity exchanges, Erkan asserted that Parliament needs to complete the new tax law with incentives for commodities futures trading. Futures contracts in Turkey are subject to a withholding tax as well as taxes on banking and insurance operations. The futures industry in Turkey hopes that a new tax bill would eliminate these transactions charges, but given the government's tight fiscal constraints it is not certain that this will happen, according to Erkan.

17. (SBU) Integral to Istanbul's future as a financial epicenter would be a modern trading infrastructure and a comprehensive national expansion and privatization of Turkey's licensed storage system, Erkan maintained. (Note: A licensed storage law has existed for some time, and the government recently provided new tax incentives which exempt licensed warehouses from corporate and income tax until 2014.

Most of the large storage facilities in Turkey are owned by the government, but they do not serve as licensed warehouses in the sense that they have no contract with a spot commodity exchange or a derivatives exchange. Statistics about the capacity of existing warehouses in Turkey are not readily available, but industry sources believe there is still room for additional storage facilities and that there is potential for private sector investment, especially if the new warehouses were to be integrated into a modern functioning capital market. End note).

18. (SBU) According to Erkan, TOBB (Union of Chambers and Commodity Exchanges) is a player in licensed storage in Turkey, and along with TMO (Toprak Mahsulleri Ofisi, the Turkish Grain Board) would almost surely be involved in this process: Erkan likened TOBB and TMO to "two dinosaurs" that have to be accommodated. TMO is the leading institute in cereal marketing, acts as a buffer stock agency to stabilize producer and consumer prices, and provides storage capacity for agricultural products such as grains. Erkan stated that TMO does not price agricultural products competitively, a situation which hopefully the new financial regime would correct.

19. (SBU) Comment. One of Turkey's success stories has been the effectiveness of BRSA, Turkey's Banking Regulation and

Supervision Agency created after the 2001 crisis, in holding Turkish banks to a high standard of capital adequacy and creditworthy lending. BRSA set Turkey's required capital adequacy ratio at 12 percent - 50 percent higher than international Basel standards - and banks in the Turkish system now average about 14 percent. BRSA regulation, the cleanup after the 2001 crash and the nascent state of the mortgage market in Turkey kept Turkish banks out of the inadequately regulated derivatives trading and distribution that crippled Western banking in recent years. Erkan's desire to bolster Istanbul's role as an international financial hub complete with stronger commodities markets will require the Turkish financial system to get into commodities trading, and necessitate a new system of regulatory checks and balances for these markets that is as effective as BRSA has been in banking, including the creation of a commodities futures trading authority. New legislation would be required to create true futures trading and, even more important, to guarantee that the government would not use TMO's purchasing authority to distort commodity price discovery. End comment.

WIENER